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SENT BY COURIER

February 29, 2000

Surface Transportation Board
Office of the Secretary
Case Control Unit
Attention: **STB Ex Parte No. 582**
1925 K Street N.W.
Washington, DC 20423-0001
U.S.A.

Dear Sirs:

RE: Public Views of Major Rail Consolidations - Ex Parte No. 582 - COUNCIL OF FOREST INDUSTRIES

Today our advisors at Hagler Bailly have delivered the Council of Forest Industries (COFI) presentation to the Office of the Secretary of the Surface Transportation Board (the Board).

The documents were sent to the Hagler Bailly's office via e-mail and the recipients were not able to open the map included with the report. Hence, we are enclosing 11 copies of the map and ask that you attach it at the end of the Council of Forest Industries reports delivered today by Hagler Bailly. Included with this package is a copy of the complete report.

If you require additional information, please contact Ian May at tel: (604) 891-1274 or via e-mail at may@cofi.org.

Yours truly,

Ian May
Vice President, Regulatory Issues

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STB *EX PARTE* NO. 582

Public Views on Major Rail Consolidations

PRESENTATION TO THE SURFACE TRANSPORTATION BOARD
SURFACE TRANSPORTATION BOARD HEARING ROOM (SUITE 760)
1925 K STREET N.W., WASHINGTON, D.C.

BY THE COUNCIL OF FOREST INDUSTRIES (COFI)
1200 - 555 BURRARD STREET
VANCOUVER, B.C. V7X 1S7 CANADA

PRESENTATION DATE: MARCH 9, 2000

STB *Ex Parte* No. 582

Public Views on Major Rail Consolidations

Presentation to the Surface Transportation Board
By the Council of Forest Industries

1. COFI:

The Council of Forest Industries (COFI) is a B.C. forest industry trade association operating in the province of British Columbia, Canada. COFI represents over 100 companies and focuses on issues which are both provincial and national in scope. The aggregate value of rail transportation shipments by COFI members to U.S. destinations is approximately $4 billion (US) annually and represents roughly 56% of our total production. Consequently, it is our position that the views of COFI's members in respect to *Ex Parte* 582 are material and relevant.

COFI members support the view of the Western Canadian Shippers' Coalition that rail consolidations such as the BNSF/CN proposal and any that may result, <u>must</u> be evaluated in a North American context.

2. ISSUES:

The Board has asked that interested persons respond to the following issues:

(a) **timing:** whether or not it is preferable to focus on improving service and to recover from current service difficulties and other disruptions, rather than focus on further consolidations

(b) **service and price:** what will the effect be on the industry's ability to provide responsive service at reasonable prices

(c) **strategic response:** will this lead to another large railroad consolidation and possibly other changes in the structure of the rail industry or in the way in which the industry is regulated

(d) **public interest:** whether or not these eventualities would be a good thing for large and small railroads, for their customers and employees and whether they would be in the public interest

(e) **financial impacts:** the effect of railroad consolidations on the financial condition of the railroad industry

(f) **operating concerns:** whether the railroad industry has and will have the necessary infrastructure, capacity and configuration to meet expected demand for freight service now and in the future

3. SUMMARY:

COFI is of the view that any large railroad consolidation is not in the public interest. We believe that the result of any large railroad consolidation would be further consolidation, to the point of creating two giant North American railroads. Now it may be that a rationalization down to two railroads, if they competed head-to-head at every origin and destination, would result in sufficient rivalry to provide shippers the benefits of competition. However, it is our observation that exposure to trucking and rail shipping alternatives are required to achieve the benefits of competition.

Many of our members choose to utilize truck transportation to reload centers in British Columbia for furtherance by BNSF rather than use a BCR/CN routing. They have found this to be an essential competitive option.

COFI also has members located on railway lines operated by CN. Many of these customers also choose to utilize truck transportation to reload centers for the purpose of accessing BNSF for shipments to the United States. The consolidation of BNSF/CN will remove this competitive option.

COFI's negative view of future consolidations is the product of experience. In British Columbia, a large number of our members are captive to BC Rail Ltd. (BCR), a provincial railway company serving shippers located in the northern part of the province. BCR physically connects with CN at Prince George, and North Vancouver. While BCR publishes open tariffs to North Vancouver which provide access to BNSF and CP, that routing is extremely circuitous and geographically disadvantageous for lumber shipment destinations in the Central and Eastern regions of the United States.

There is no comfort in the fact that the removal of Burlington Northern still leaves two large rail carriers available to shippers. The fact of the matter is that the CN and CP do not compete unless they serve the same origin or destination. Nor is it safe to assume that competition can be simulated through regulation. The *Canadian Transportation Act* (CTA) contains provisions designed for such a purpose. Unfortunately, CP and CN have not embraced the spirit of those regulations and have instead refused to offer competitive rates.

4. REASONS:

Timing

You will no doubt hear from many who believe that this is not the right time for another rail carrier consolidation. We have yet to see the benefits of previous efforts and the resultant disruption has yet to settle out. Why offer another disruption to a system still struggling to gain its equilibrium? We support that concern and offer some other "timing" issues for consideration.

As shippers of forest products, we know the benefits of consolidation well. We engage in the practice in order to better compete in our marketplace. The benefits of consolidation, allow us to meet the service, quality and most important of all, pricing challenges posed by an expanding number of international competitors. One could argue that railroad consolidation offers the same advantages, but there are critical differences.

- Railroad consolidation has yet to demonstrate it can produce greater efficiencies
- Railroad consolidation, unlike forest industry consolidation, leaves too few

players in the game

- Customers have yet to see a more competitive price result from rail consolidation
- At a time when our markets are expanding and growing more competitive, railroad consolidation is out-of-step in that it shrinks rather than expands customer choice.

Service and Price

Let us say, right at the beginning, that service and price are intertwined. Great service at high prices in our competitive will not open doors to new business. Competitive prices on products that aren't reliably delivered mean will result in the erosion of our customer base. We must be able to provide competitively priced product where and when the customer requires it, or someone else will.

Given the history of railroad consolidations, one can be forgiven a cynical appraisal of the chances of future consolidations delivering promised improvements to service. However, in the spirit of optimism, let us assume that all goes well and the anticipated service benefits result. That is only half the battle. Invariably, carrier profits increase as productivity improvements are realized. We have yet to hear even a whisper about lower rates as a result of a railroad consolidation and unless that is part of the package, consolidation is just another way of saying higher prices.

Public Interest

Consolidations, at least preemptive consolidations, are not intended to level the playing field for customers and provide honest choices between vibrant competitors. They are carefully planned and executed to do just the opposite: to give one carrier an advantage over others. The invariable result is a defensive consolidation among remaining carriers in order to protect or recoup market share. The public interest is not a prime motivator in this cycle. Nor is the welfare of small and regional carriers. Both groups tend to fall victim to reactive mergers.

Reactive mergers, because of their very nature (time is of the essence), tend to take place too quickly, with too little planning and predictable chaos. It is the small carrier who suffers along with the public interest. Small carriers, now facing captivity to a larger railroad have little choice but to accept a strategic consolidation with another carrier in order to maintain any competitive leverage. This in turn results in greater shipper captivity. Should reasonable levels of efficiency and productivity be restored, there are now fewer choices for shippers and less likelihood of competitive pricing.

At the end of this cycle, the shipper is left to contemplate an experience that exposed him to poor service, followed by promises of improvements, followed by chaos, followed by a dual monopoly. This likely result of future consolidations is simply too pernicious to contemplate. In a world of just-in-time delivery, innovative and relentless international competition, North American shippers can ill afford the risk.

Financial Impacts

Railroads need to reinvest in their infrastructure in order to maintain service levels and remain competitive. Concerns with the disposition of capital, in the event the BNSF/CN consolidation occurs, have been voiced on both sides of the border. Americans fear the proposed structure of the Board of Directors (a majority of Canadians) will result in Capital being expended along nationalistic lines. Canadians fear that Return on Investment (ROI) will be the deciding factor and due to the size of the U.S. market, ROI numbers will consistently favour investments south of the border, resulting in a deterioration of Canadian infrastructure.

With respect to our American counterparts, the CNR has told us that capital expenditure decisions will most certainly be made on the basis of ROI. That is not good news for smaller markets on either side of the border.

Effect on Customers

Some customers of the major railroads enjoy access to more than one railroad. Many do not. For the vast majority of COFI members and their individual operations, captivity to one railroad is the norm. Even in cases where truck access to another railroad is possible, it is often inadequate from a capacity standpoint and/or economically disadvantageous. Consequently, the elimination of such railroad alternatives through further consolidation, would harm what little restraint on price increases remains in the origins concerned. Any alleged service improvements coming as a result of consolidation will be outweighed by the elimination of competitive restraints on price.

Direct customer impacts are not the only possible result that should be considered. A quick look at the attached BNSF/CN North American route map is revealing. The Port of Vancouver is, for all practical purposes, the same distance as the Port of Oakland, from Chicago. Given the routing options available through any of the west coast U.S. ports compared to Vancouver, it may be only a matter of time before traffic migrates south. This would result in deteriorating service to and from the Port of Vancouver and a subsequent degeneration in the service available to Western Canadian shippers.

Operating Concerns

It has been argued that end-to-end mergers minimize service disruption and result in increased efficiencies. We agree that those are possible outcomes, but we are also cognisant of the likelihood that monopolistic behaviour will occur. Should a duopoly ultimately result, the ability of the North American rail system to provide the necessary capacity, infrastructure and configuration, will be greatly limited. It is the nature of monopolies, dual or single to, maximize utilization of areas providing high returns while rationalizing areas of low return. This will result in service reductions as railroad companies seek to maximize profits.

COFI believes that only through real competition can shippers be assured of a railroad system that will adequately address concerns about future capacity, configuration and infrastructure. It follows that any step toward reduced competition is a step in the wrong direction.

5. CONCLUSION:

It is the position of COFI members that railroad mergers/consolidations bring with them the certainty of shipper and small railroad captivity. The usual result being increased price and poorer service. If railroad consolidation is to result in cost reduction through the elimination of redundancy, captivity and reduced capacity must follow. It is difficult to see the how the public interest will be served by such activities.

We would argue that there is no need for consolidation between two vibrant and healthy railroads in order to gain efficiency and service improvements. These ends can be achieved through strategic agreements on infrastructure, marketing and traffic interchange as illustrated by the Chicago example.

COFI members are living witness to the effects of current and future rail captivity. We also understand the discipline a competitive marketplace can impose on suppliers. It's time the railroads received the same benefit.

All of which is respectfully submitted this 29th day of February, 2000.

Presented by:

Ian May

Council of Forest Industries
Ian May, Vice President, Regulatory Issues

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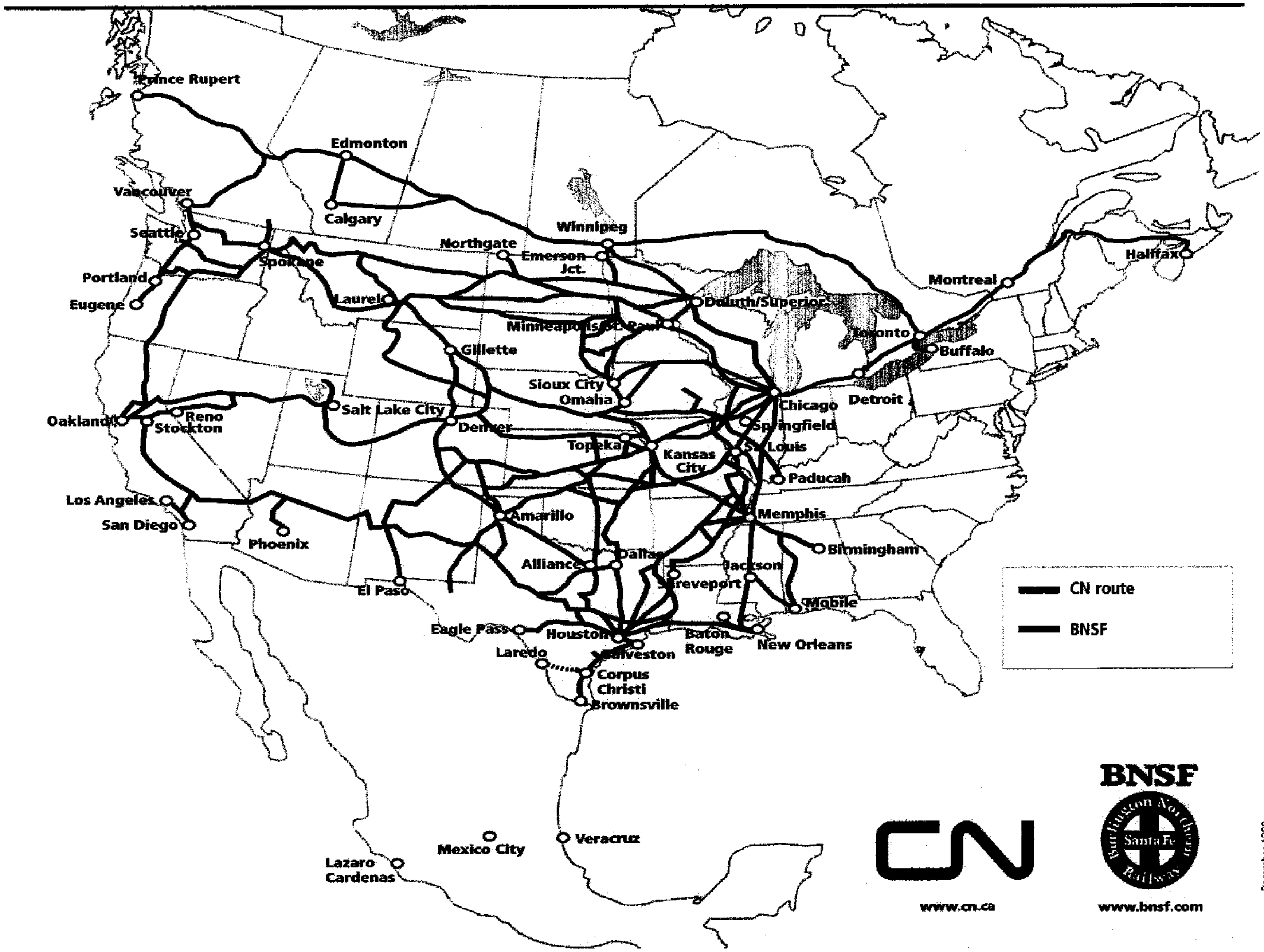
A New Railroad for a New Era



December 1999